Employment Taxes—Who *Is* Responsible?

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Joseph Kehoe and Mark Matthews discuss employer and employee responsibility for employment taxes and describe common employment tax evasion schemes.

Both employer and employee hold the responsibility for collecting and remitting withholding taxes to the IRS. For the most part, employers withhold these taxes on behalf of their employees; but in cases where an employer does not do this, or where an employee is self-employed, it is the responsibility of the employee to collect and pay withholding taxes. If you keep this issue in mind when working with your clients, you can help them meet their tax compliance obligations.

Employment taxes include federal income taxes, Social Security and Medicare taxes. Employees contribute part of these taxes through withholding by their employers, with the employer paying a matching amount. Programs funded by employment taxes provide essential benefits to citizens. Social Security and Medicare taxes pay for benefits workers and their families receive under the Federal Insurance Contributions Act (FICA). Social Security taxes provide for benefits under the old age, survivors and disability insurance portion of FICA. Medicare taxes pay for hospital benefits.

Employers also pay Federal Unemployment (FUTA) taxes, which are not withheld from employees' wages. The FUTA taxes pay unemployment compensation to workers who lose their jobs.

Employers' Responsibility

Employers *must report* income and employment taxes withheld from their employees on an Employer's Quarterly Federal Tax Return (Form 941) and *deposit these taxes*, in full, to an authorized bank or financial institution pursuant to Federal Tax Deposit Requirements. Employers are also responsible for filing a FUTA return annually, and depositing those taxes.

Employers who do not comply with the employment tax laws may be subject to criminal and civil sanctions for willfully failing to pay employment taxes.

Employees' Responsibility

Employees who neither have taxes withheld, nor remit them personally, are still liable for these taxes and may not qualify for Social Security, Medicare or unemployment benefits.

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Employees who are concerned that their employer is improperly withholding or failing to withhold federal income and employment taxes should contact the IRS at 1-800-829-1040. In cases where the employer withheld employment taxes but failed to deposit them, or failed to issue W-2s, the employee should contact the employer to request the W-2. If the employee is unable to secure a W-2 from the employer, the employee should complete and attach Form 4852, Substitute for W-2, to his or her tax return using the best information available to calculate the wages and the withholding. This information can often be secured from pay stubs.

In addition, if the employer refuses to withhold employment taxes from these wages and the IRS is unable to collect the employment taxes from the employer, the employee still has the responsibility to pay income tax and ultimately is responsible for his or her share of the FICA tax.

Figure 1:
http://www.treas.gov/irs/ci/tax_fraud/docemploymenttax.htm

HOME : Tax Fraud Alerts : Employment Tax Enforcement Program

This page was last revised on May 4, 2001,
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Employment Tax Enforcement Program

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Employment Tax Requirements

Employers are required by law to withhold employment taxes from their employees. Employment taxes include:

- Federal Income tax withholding
- Social Security and Medicare Taxes
- Federal Unemployment Tax

The federal income tax is a "pay as you go tax." You must pay the tax as you earn or receive income during the year. For most employees this takes the form of income taxes withheld from their pay. Self-employed persons are also required to make estimated tax payments during the year. The pay as you go system was designed to ensure that taxpayers meet their tax obligations timely.

IRS Enforcement of the Employment Tax Laws

IRS has detected and recommended prosecution for several types of employment tax evasion schemes. Some of the more prevalent types of tax evasion include pyramiding, employee leasing, paying employees in cash, filing false returns or failing to file payroll tax returns.

Pyramiding

Pyramiding of employment taxes is a fraudulent practice where a business withholds taxes from its employees but intentionally fails to remit them to the IRS. Businesses involved in pyramiding frequently file for bankruptcy to discharge the liabilities accrued, then start a new business under a different name and begin a new scheme.

Case in Point. On April 23, 2001, C. David Morrison, a former hospital administrator, was sentenced to eight years and one month in prison, then five years supervised release, and ordered to pay $374,000 in restitution to the hospital. On November 29, 2000, a federal jury convicted Morrison on 23 counts of financial-related crimes, including tax evasion, money laundering and embezzlement. Morrison failed to pay more than $4.5 million withheld from hospital employees' paychecks and diverted the tax money toward the building of a mall project. Morrison used hospital money to pay for his share in the purchase of a $1.3 million private airplane. The payments used to fund Morrison's ownership and upkeep of the aircraft were structured in such a manner as to conceal the fact that the hospital was making the payments on Morrison's behalf. Hospital funds were also used by Morrison and a business partner to keep afloat a joint business and to renovate and pay off loans on a motel and several rental properties. The financial crimes against the hospital and its employees forced the hospital into Chapter 11 bankruptcy.

Employee Leasing

Employee leasing is the practice of contracting with outside businesses to handle all administrative, personnel and payroll concerns for employees. In some instances, employee-leasing companies fail to pay over to the IRS the collected employment taxes. These taxes are often spent by the owners on a variety of business and personal expenses. The company dissolves, leaving millions in unpaid employment taxes.

Case in Point. In 1998, Richard Dvorak, former President of Persona Management Corporation, an employee leasing firm, was sentenced to 41 months in prison for filing seven fraudulent quarterly payroll tax returns, understating his firm's employment tax liability by more than $13 million. During 1992 and 1993, Persona Management Corporation "leased" almost 6000 employees to over 100 businesses. These businesses entered into arrangements with Persona Management Corporation to turn their employees over to Persona and then lease them back to realize savings on health and workman's insurance, pension plan costs and payroll services. Instead of paying employment taxes on these employees, Dvorak used the money to support a lavish lifestyle.

Paying Employees in Cash

Paying employees in whole or partially in cash is a common method of evading income and employment taxes, resulting in lost tax revenue to the government and the loss or reduction of future Social Security or Medicare benefits for the employee.

Case in Point. Albert Snow operated two health food stores and a bookstore. During tax years 1993 through1998, he failed to file tax returns or pay any income tax. To conceal his income, Snow required all employees to accept their wages in cash, failed to withhold payroll taxes, commingled his personal and business expenses, and destroyed business records. In August 2000, Albert Snow was sentenced to three years and seven months in prison for evading and failing to pay over $500,000 in income taxes and payroll taxes, conspiring with others to defraud the government, making false statements to banks and paying unlawful gratuities to a public official.

Figure 2: IRS Criminal Investigation Employment Tax Evasion Data

During Fiscal Years 1998, 1999 and 2000, nearly 86 percent of the persons convicted of evading employment taxes were sentenced to an average of 17 months in prison and ordered to make restitution to the government for the taxes evaded (plus interest and penalities.)

Three Year Totals:	
Investigations Initiated	112
Prosecution Recommendations	159
Indictments/Informations	137
Sentenced	127
Three Year Average:	
Incarceration Rate*	85.8%
Average Months to Serve	17

*Incarceration includes confinement to federal prison, halfway house, home detention or some combination thereof.

In addition to jail time, Snow received five years supervised release, was fined $100,000 and ordered to assist the IRS in determining his outstanding tax liability.

Filing False Payroll Tax Returns or Failing to File Payroll Tax Returns

Preparing false payroll tax returns, understating the amount of wages on which taxes are owed or failing to file employment tax returns are methods commonly used to evade employment taxes.

Case in Point. In August 2000, Joann A. Reynolds, Vice President of D. Reynolds Machine Co., was sentenced to one year and one day in prison and fined $3,000. Reynolds pled guilty to two counts of failing to account for and pay over federal employment taxes owing on the wages of Reynolds Machine Co. employees and one count of filing a false federal income tax return. Reynolds failed to pay over $62,360 of withheld income taxes and the employees' share of Social Security taxes. The indictment also charged she failed to pay the employer's share of Social Security taxes totaling approximately $21,876.

During the last three fiscal years (1998, 1999 and 2000), nearly 86 percent of those individuals convicted of evading employment taxes were sentenced to an average of 17 months in prison and ordered to make restitution. Is it a risk worth taking?

To learn more about the requirements to pay employment taxes, see Publication 15 (Circular E, Employer's Tax Guide) and Publication 15A (Employer's Supplemental Tax Guide). Both publications can be found on the IRS website at *http://www.irs.gov.* To learn more about the IRS enforcement efforts in the area of employment tax fraud, go to the IRS Criminal Investigation website at *http://www.treas.gov/irs/ci.*

Figure 3:
http://www.irs.gov/smallbiz/index.htm